THE ENTERPRISE OF THE FUTURE

IMPLICATIONS FOR MIDSIZE ORGANISATIONS

IBM

GLOBAL CEO STUDY

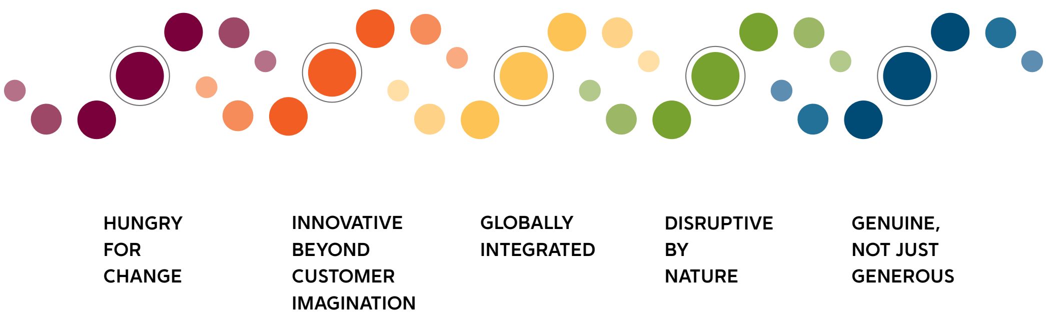
INTRODUCTION

We conducted 1,130 interviews with chief executives, general managers, business leaders and public-sector heads in the course of completing the research for our third biennial Global Chief Executive Officer (CEO) Study, which aims to identify the key characteristics of the Enterprise of the Future.[1] Here we focus on the responses of the 136 "midmarket CEOs" who head midsize organisations (defined as companies that employ fewer than 1,000 people).[2]

As part of our research, we sought to understand the differences between the responses of financial outperformers and those of underperformers. We compared the revenue and profit track records of those companies with publicly available financial information against the averages for their industries within our sample.[3] We labelled companies that performed above the average on a particular financial benchmark outperformers and those below the average underperformers. Throughout our analyses, we looked for insights based on these top- and bottom-half groupings.

Our findings show that the Enterprise of the Future is:

- **Hungry for change**
- **Innovative beyond customer imagination**
- **Globally integrated**
- **Disruptive by nature**
- **Genuine, not just generous.**



HUNGRY FOR CHANGE

Midmarket CEOs foresee significant change ahead, but they're not confident about their ability to manage it. So how will they fare in an increasingly turbulent environment?

Midmarket CEOs anticipate more change than other CEOs but are less successful at managing it. The gap between those who think that their companies will need to make substantial changes over the next three years and those who say that they have previously succeeded in managing change is even bigger in midsize organisations than it is in our overall sample (see Figure 1).

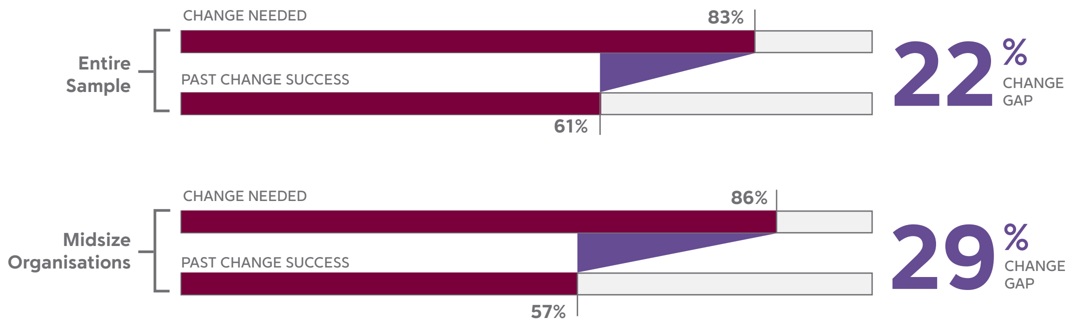
Many midmarket CEOs also report that they are struggling to keep up. They feel that consumers are now dictating the pace of change, whereas formerly they were the ones in control. "Change in the organisation is not happening fast enough...The gap is widening," one Dutch midmarket CEO told us.

This may seem surprising, since people often assume that smaller companies are more agile than large ones. But midsize organisations typically have fewer resources and thus less "bandwidth" for handling unexpected or disruptive external influences. They also operate in fewer countries and offer fewer products or services, so they have less experience in managing such turbulent, global change.

Moreover, the sheer breadth of the changes midmarket CEOs face is increasing. In 2004, market factors (such as variations in customer purchasing patterns, growing competition and industry consolidation) dominated the boardroom agenda. Today, however, midmarket CEOs have to focus on a much broader range of concerns. Market factors remain their top priority, but access to people with the skills they need, regulatory compliance, technological factors and globalisation also weigh heavily on their minds. Regulation is a source of particular anxiety; 37 percent of midmarket CEOs think it will bring major changes, compared with just 30 percent of the total survey population.

FIGURE 1 THE CHANGE GAP IN MIDSIZE ORGANISATIONS

Managing change is an even bigger challenge for midmarket CEOs than it is for the total survey population.



These issues are connected. Any company that wants to capitalise on the trend toward globalisation and expand into new markets will need to understand the potential opportunities and risks. It will also need to recruit people with the expertise – be it industrial, technical or managerial – to operate in an increasingly complex, geographically diversified environment; contend with different regulations in different jurisdictions and build a technological platform capable of supporting its key business processes on a multinational basis. However, many midsize organisations lack sufficient in-house skills to manage change in multiple countries, especially regulations in markets that are new to them.

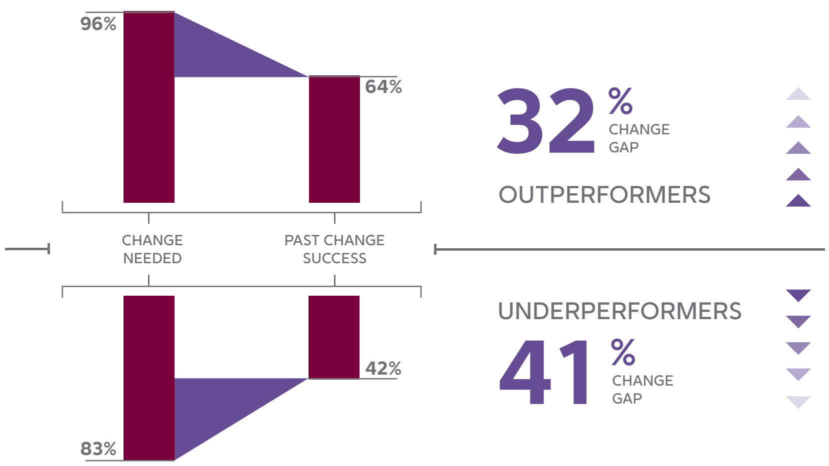
In short, globalisation is creating many more challenges; rather than being able to concentrate their efforts on a few specific issues, midmarket CEOs must now cover a much wider front and cope with much greater uncertainty. They must "master complexity," as one respondent put it – for everything is important and change can come from anywhere.

OUTPERFORMERS MANAGE CHANGE MORE SUCCESSFULLY

Nevertheless, difficult though it is to manage change, a number of midsize organisations have been very successful in doing so – and it is no accident that they are also thriving. When we looked at the financial outperformers in our sample, we noted that they anticipate more change than the underperformers. They are also much better at handling change (see Figure 2). In effect, outperformers welcome change and see it as an intrinsic part of their activities.

FIGURE 2 OUTPERFORMERS ARE BETTER AT HANDLING CHANGE

Financial outperformers expect more change and are better at managing change than underperformers.[4]



Implications

With more change taking place faster than ever before, midsize organisations can no longer rely on their small size to make them nimble and adaptable. They need to develop more sophisticated change management capabilities and build a technological infrastructure that is flexible enough to cope with the increasingly frenetic rate of change. They also need to compete more effectively in the global battle for talent. Some companies may choose to focus on recruiting and developing people internally. That, in turn, means they will require robust recruitment, employee development and performance management processes. Many companies will also form partnerships with other companies in the new markets and countries in which they want to operate and supplement their in-house resources with external expertise.

INNOVATIVE BEYOND CUSTOMER IMAGINATION

Midmarket CEOs are investing heavily to capitalise on the opportunities arising from greater global prosperity and serve increasingly sophisticated consumers. The question is: how can they make these investments pay off?

The middle class is growing in rapidly emerging economies and becoming increasingly affluent. Meanwhile, in established economies, ageing baby boomers have accumulated significant assets, which many will pass on to their offspring. Greater global prosperity is stimulating demand for new products and services and thereby creating new growth opportunities for many companies. Consumers are simultaneously becoming much better informed – thanks largely to the Internet, which has made it easier to shop around and make more informed purchases.

Midmarket CEOs are optimistic about both these trends. Two-thirds of them view the increase in the purchasing power of consumers very positively, although they recognise that serving the needs of new demographic and geographic market segments will require major changes in the way they work. Four-fifths of them also welcome the advent of "information omnivores." The "customer is now informed but not loyal," so the customer "relationship is key" to success, one respondent noted.

ACTIVE PARTNERING IN BURGEONING MARKETS

In fact, midmarket CEOs have already devoted a larger share of their total investments to capitalising on rising prosperity and serving informed customers than the CEOs in our overall survey sample have done.[5] And they plan to increase the amount they invest in increasingly prosperous consumers by 20 percent over the next three years. They are typically focusing on forming new business relationships, because they lack the internal resources to meet these more diverse needs. "We hope to seek large, outstanding partners to further increase our competitiveness to adapt to changing market needs," one midmarket CEO explained.

NEXT-GENERATION PRODUCTS AND SERVICES

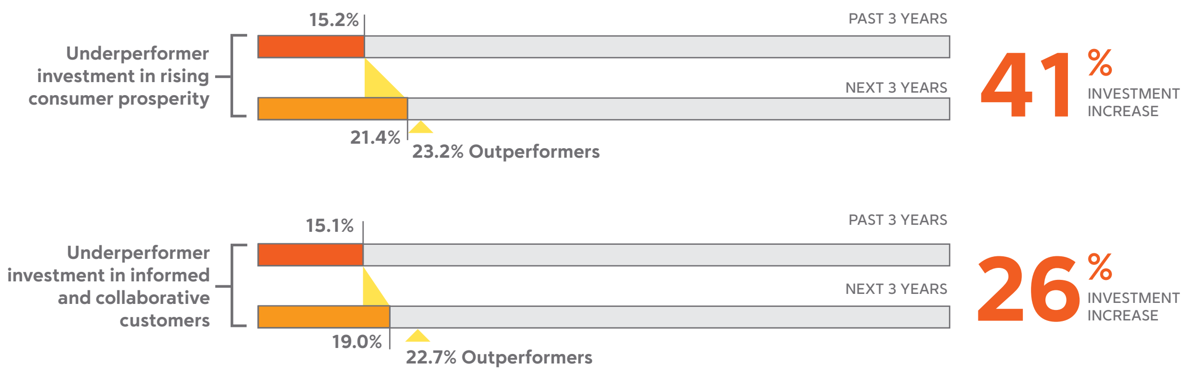
They also plan to channel more than 22 percent of their budgets into meeting the needs of information omnivores. Most companies are focusing on the development of "the next generation of products" and services and "how to attract" these customers, as one respondent put it. But informed consumers not only want to know about the products and services they buy, they want to know about the organisations from which they buy those products and services. Many midmarket CEOs are therefore focusing on implementing environmental initiatives, building brands that appeal to such consumers and becoming more transparent.

OUTPERFORMERS ARE EVEN MORE CUSTOMER-FOCUSED

Again, however, there are some substantial differences between the financial outperformers and underperformers in our survey sample. The outperformers have historically invested a greater share of their total budgets in reaching both more prosperous and better informed customers than the underperformers have done. But the underperformers now plan to boost the amount they invest in both areas over the next three years, in a bid to catch up with their more successful peers (see Figure 3). “We need to identify the ‘next wave’...We’re late in working with the emerging markets,” one midmarket CEO explained.

FIGURE 3 UNDERPERFORMERS ARE TRYING TO CATCH UP

Underperformers plan to substantially increase their investments in capturing rising prosperity opportunities and serving informed customers, but they will still lag behind outperformers.



Implications

Our findings suggest that midsize organisations have several advantages over bigger companies when it comes to serving new markets and customer segments. They have already invested a larger percentage of their budgets in customer initiatives and smaller companies can often forge more intimate relationships with their customers. The Internet has also created numerous new opportunities to sell the "long tail" of products that appeal to niche tastes and some midsize organisations may be in a strong position to profit from such opportunities.[6]

However, they will need to make sure that they capitalise on the investments they are making. Alliances with strategic partners are likely to play a key role in helping many midsize organisations tap into the potential of developing economies. New technologies will also be essential to identify different customer segments, respond to changing customer preferences, develop new channels to market and provide new sources of differentiation.

GLOBALLY INTEGRATED

Faced with so many choices about how to make their companies more globally integrated, how should midmarket CEOs respond? How should they design their businesses to take advantage of capabilities located in other parts of the world? When should they form partnerships or acquire other companies?

As the world becomes more connected and more prosperous, mid-market CEOs are increasingly keen to expand their reach. But they recognise that this will require greater global integration. Succeeding in "a smaller world in a hyper-competitive economic climate," as one respondent noted, will demand new business designs that facilitate faster and more extensive collaboration on a worldwide scale and rapid reconfiguration when new opportunities appear.

DEEPER CAPABILITIES AND EXTENSIVE PARTNERING KEY TO GOING GLOBAL

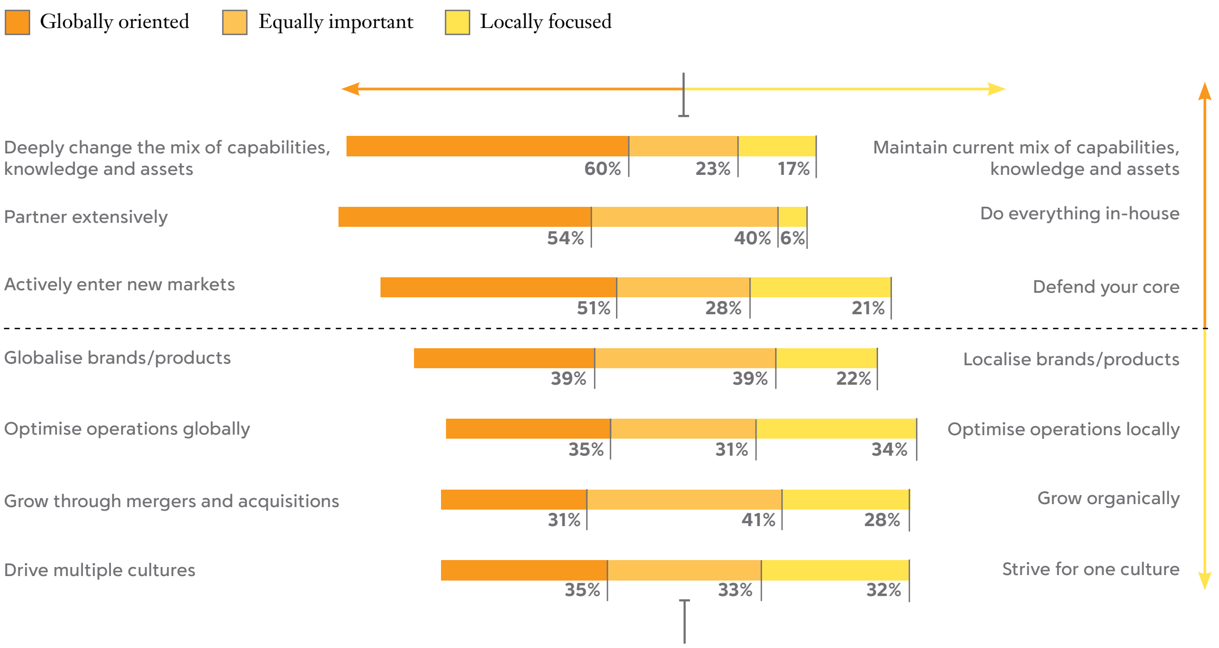
More than half of all midsize organisations are actively entering new markets and three-quarters are adopting global business designs. Indeed, they are making more efforts to become globally integrated than the total survey population.

Midmarket CEOs are focusing primarily on making major changes in their companies' capabilities, knowledge and assets and forming numerous new business partnerships (see Figure 4). Lacking the resources of multinational organisations, they know that they will need to form alliances with compatible companies in the regions they want to reach, acquire a much deeper understanding of their potential customers and recruit managers with international experience before venturing too far. "We will enhance our business acumen, make new investments and develop new strategies," one respondent explained. "We need to get into new partnership models to have the ability to deliver new services and meet demand," said another.

However, midmarket CEOs are much more divided about whether to globalise their brands and products, build globally integrated operations and grow through mergers and acquisitions or whether to maintain a local focus, grow organically and strive for a single corporate culture. In short, it seems that although they know what to do – and some CEOs will almost certainly choose to remain local rather than "going global" – they are much less sure about how and when to capitalise on global integration opportunities.

FIGURE 4 MIDMARKET CEOs FOCUS ON NEW SKILLS AND KNOWLEDGE

We asked midmarket CEOs to describe seven aspects of their plans for becoming globally integrated.



SHORTAGE OF TALENT A GLOBAL CHALLENGE

Midsize organisations also face a number of barriers to global integration, although the two biggest obstacles are not, perhaps, those one might first expect. The usual hurdles – money, cultural differences and technological issues – come much further down the list than shortage of talent and the growing regulatory burden, which more than half of all midmarket CEOs regard as major problems. "Local market skills levels are a constraint," one midmarket CEO told us, adding: "We need to build a knowledge-based workforce."

However, the shortage of managerial talent is, arguably, even more pressing. Companies that want to become globally integrated need executives with global experience, who can look at the bigger picture and feel comfortable managing people from very different backgrounds and across geographic boundaries.

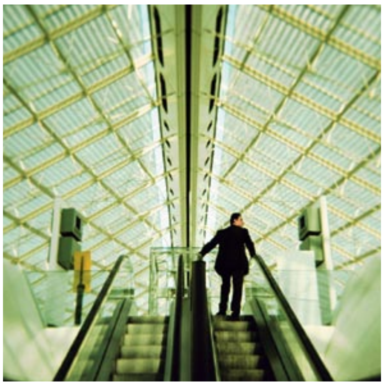
OUTPERFORMERS HAVE MORE GLOBAL BUSINESS DESIGNS

Despite these difficulties, it is clear that many of the financial outperformers in our sample are successfully making the transition. Our conversations with many CEOs suggested that their responses formed an interlinked pattern. Further analysis of the responses of the total survey population, using data clustering techniques, enabled us to identify four common approaches to global integration: we have called them "globalisers"; "extensive globalisers"; "blended thinkers" and "localisers." It also showed that the percentage of outperformers that are globalisers or extensive globalisers is significantly higher than the percentage of underperformers in either camp.

Midsize organisations exhibit some similar trends. The outperformers are far more likely than the underperformers to be planning major changes in their capabilities, knowledge and assets (63 percent versus 50 percent) and pursuing new markets (53 percent versus 44 percent). In other words, they are more actively making some of the key alterations required to become globally integrated.

Implications

The global economy is not just an opportunity for large companies; thanks to ubiquitous connectivity, smaller businesses can be global players, too. However, the path to global integration is often more challenging for midsize organisations, many of which have spent most of their history operating on a local or national scale. Some midsize organisations may decide to extend their reach by engaging in mergers and acquisitions, while others favour joint ventures or more informal arrangements. In any case, they will need to become more open and collaborative. They will also need to preserve the best of the entrepreneurial culture that has enabled them to grow, blend it with the different cultural influences to which they are exposed through the drive toward globalisation and balance it with a more formal structure as they expand.



DISRUPTIVE BY NATURE

Most midmarket CEOs are embarking on extensive business model innovation. And outperformers are making even more far-reaching changes than their underperforming peers. But will these daring moves pay off? What will it take for them to truly differentiate their companies, products and services?

Midmarket CEOs are embarking on even more extensive business model innovations than many of their peers in larger companies. Seventy-four percent plan to substantially change their business models over the next three years, versus 69 percent of the overall sample. They told us that this is partly because they are finding it increasingly difficult to differentiate their companies through products and services alone, and partly because technological advances have given them many more options.

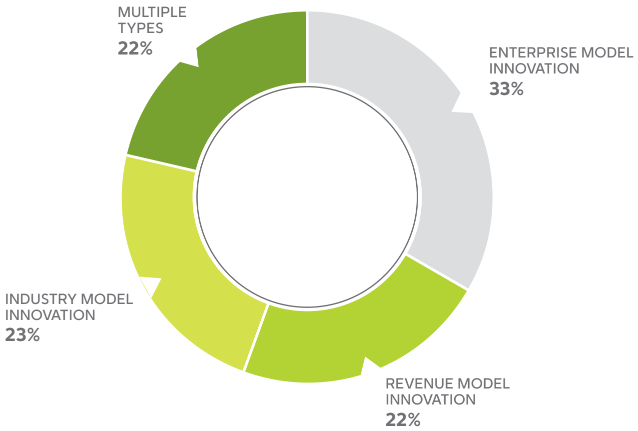
ENTERPRISE MODEL INNOVATION LEADS THE WAY

Of those that plan to substantially change their business models, 33 percent are focusing on enterprise model innovation (see Figure 5).[7] They clearly recognise that addressing new markets and customer segments will necessitate changes that go far beyond a few tweaks.

Another 22 percent of midmarket CEOs are engaging in revenue model innovation. One respondent, for example, is focusing on "new services to existing customers" and "new ways to sell and price," while a second aims to shift from a "transaction-based" pricing regime to a "fee-for-service" model that is "more value-based."

FIGURE 5 ENTERPRISE MODEL INNOVATION DOMINATES

Midmarket CEOs are focusing on reconfiguring their businesses to specialise and collaborate.



TYPES OF BUSINESS MODEL INNOVATION CONSIDERED

Enterprise model
Specialising and reconfiguring the business to deliver greater value by rethinking what is done in-house and through collaboration (as Cisco has done by focusing on brand and design while relying on partners for manufacturing, distribution and more)

Revenue model
Changing how revenue is generated through new value propositions and new pricing models (as Gillette did by switching the primary revenue stream from razors to blades)

Industry model
Redefining an existing industry, moving into a new industry, or creating an entirely new one (think music industry and the Apple iPod and iTunes)

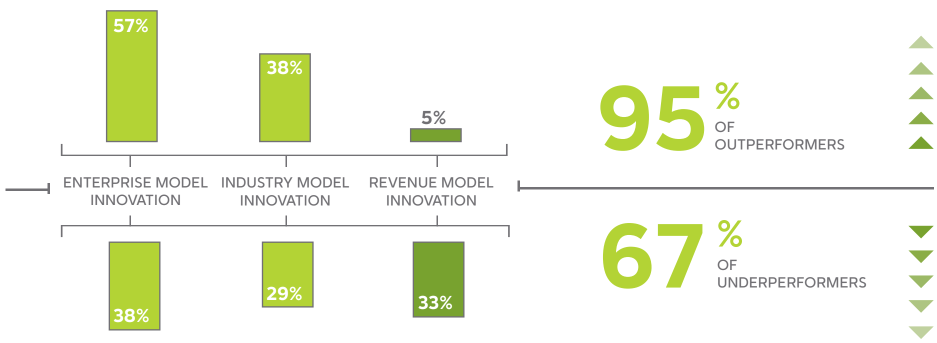
Similarly, 23 percent are undertaking industry model innovations. The vast majority of these respondents plan to redefine the industry in which their companies are operating. Surprisingly, however, 39 percent of this group aims to create entirely new industries. Although this is the most challenging form of innovation in which any company can engage, radical innovation often starts on a small scale, as the genesis of corporate giants like Microsoft® and Google shows.

OUTPERFORMERS MAKE MORE FAR-REACHING CHANGES

The marked variation in the preferences of outperformers and underperformers suggests that some of these ambitions might indeed produce groundbreaking changes. The outperformers in our survey sample are much more likely to plan on altering their industry models or enterprise models than the underperformers are – clear evidence that they are willing to be more disruptive, take more risks and are better able to make those risks pay off (see Figure 6).

FIGURE 6 OUTPERFORMERS TAKE MORE RISKS

Outperformers are much more likely than underperformers to embark on enterprise model and industry model innovation.



Implications

Midsize organisations are well placed to be the disrupters in their industries; they are more willing both to change their business models and to make more dramatic shifts than other organisations. The majority of the companies in our sample are currently developing solid strategies and value propositions to differentiate themselves more effectively – and some firms may need to specialise in order to separate themselves from the crowd, since they cannot call on the same economies of scale large multinational corporations enjoy. They are then assessing what they can do to improve their internal operations, given their existing business models and resources, before looking for partners to help them execute their plans and fill the gaps.

GENUINE, NOT JUST GENEROUS

An emerging generation of socially minded customers, workers, partners, activists and investors is watching virtually every move companies make. Midmarket CEOs are well aware of this change in attitudes. So how can they meet rising expectations for corporate social responsibility?

As customers, employees, investors and other stakeholders become more socially minded, CEOs are increasingly focusing on corporate social responsibility (CSR). The importance they accord socioeconomic factors, environmental issues and people skills has consistently risen since 2004, when we conducted our first Global CEO Study.

MIDSIZE ORGANISATIONS INVESTING SERIOUSLY IN CSR

Midmarket CEOs view CSR just as positively as the CEOs of other organisations; 69 percent believe CSR will ultimately be beneficial. An enterprise must "create profits, but it must also take responsibility for its employees, consumers and the environment," one respondent noted.

Moreover, midmarket CEOs are prepared to invest in this area. They plan to increase the amount they spend on CSR initiatives by 34 percent over the next three years (see Figure 7). This is significantly more than the amount by which they intend to lift their investments in other strategic areas including capturing rising prosperity opportunities (20 percent) and serving informed consumers (11 percent).

However, midsize organisations are still lagging behind the total survey population in terms of the percentage of investment they propose to devote to CSR (10.3 percent versus 13.4 percent). We suspect that they are also at an earlier stage of development when it comes to embedding CSR in their overall strategies, processes, products and services.

FIGURE 7 MIDMARKET CEOS ARE BUYING INTO THE CSR AGENDA

Midsize organisations are increasing their investments in CSR by more than one-third over the next three years.

The primary CSR focus of the companies in our global sample is the development of new products and services to meet the growing demand for socially responsible goods. The formation of new business relationships and introduction of more transparent reporting systems is relatively low on their agendas. Midsize organisations, by contrast, are concentrating on implementing environmental initiatives and forming new business relationships to help them address rising CSR expectations, a distinction that suggests they are still laying the groundwork. Nevertheless, midmarket CEOs are acutely conscious of the sea-change in attitudes that is taking place. "Environmental issues are becoming more important every day," one respondent commented, while a second observed that "a green label is becoming mandatory."

Implications

Midsize organisations see CSR as an opportunity to generate further growth, recognising that perceptions of their brands will be crucial in attracting new customers and employees alike. But they are still catching up with other organisations. They need to define what CSR really means to them, learn more about the expectations of their customers and identify how best to produce the sort of goods and services that will meet those expectations. They also need to think about how CSR will affect their ability to attract the talent they need to expand and become more globally integrated.

BUILDING YOUR ENTERPRISE OF THE FUTURE

Midmarket CEOs fundamentally agree with the CEOs in our overall survey sample about the features that will characterise business in the future. Their responses suggest that the Enterprise of the Future – as we have called it – will be hungry for change, innovative beyond customer imagination, globally integrated, disruptive by nature and genuine, not just generous.

However, the challenges they face differ in a number of respects. They anticipate more change but feel less confident about managing it successfully. They plan to reconfigure their business models more extensively. They are still grappling with the development of products and services for socially responsible consumers. And most of those that want to become globally integrated are starting from an earlier point on the journey than their larger multinational competitors.

The critical question is: will they be ready? Do they have the adaptable workforce and skills they need to manage more change at a faster pace and capitalise on the new opportunities that globalisation, increasing affluence and greater connectivity are creating? The partners they need to help them enter new markets? The flexible infrastructure they need to pursue business model innovations, respond to the demands of different customer segments and develop new channels to market?

We look forward to learning more about where you think your business is heading – and working with you, as you build your Enterprise of the Future.

For additional information about the IBM Global CEO Study, please visit **ibm.com**/enterpriseofthefuture

ABOUT IBM GLOBAL BUSINESS SERVICES

With business experts in more than 170 countries, IBM Global Business Services provides clients with deep business process and industry expertise across 17 industries, using innovation to identify, create and deliver value faster. It offers one of the largest Strategy & Change practices in the world, with over 3,250 strategy professionals.

Our General Business consulting practice understands the needs and challenges of the midsize organisation and leverages its size, scale and experience to deliver a portfolio of solutions and services designed specifically for the midmarket. For more information about IBM Global Business Services and our Midmarket expertise, visit **ibm.com**/gbs/uk/midmarket

NOTES AND SOURCES

[1] "The Enterprise of the Future: The IBM Global CEO Study." IBM Institute for Business Value. May 2008. Our overall survey sample is representative of opinions throughout the world: 31 percent of respondents are based in the Americas; 36 percent in Europe, the Middle East and Africa; and 33 percent in Asia Pacific. The vast majority of these leaders were interviewed by IBM executives in face-to-face interviews lasting one hour. The Economist Intelligence Unit administered the remainder of the interviews by telephone.

[2] For readability, we have referred to all respondents as "CEOs" throughout the remainder of our report. We have referred to those who head midsize organisations as "midmarket CEOs."

[3] For analytical and statistical reasons, we compared performance on three financial benchmarks: 1) Revenue compound annual growth rate (CAGR) 2003 to 2006; 2) Net profit margin CAGR 2003 to 2006; and 3) Absolute profit margin average for 2003 and 2006.

[4] Of the 136 midsize organisations included in our survey, 64 had publicly available financial information and were included in our financial analysis.

[5] In our survey, the term "total investments" was defined as: all asset investments plus investment in research and development, marketing and sales.

[6] Andersen, Chris. *The Long Tail* (Random House: June 2006). Bricks-and-mortar retailers only stock the products they believe will be most popular, because shelf space is expensive. But online retailers like Amazon and iTunes can stock virtually everything, and the number of niche products on the market is far greater than the number of "hits." These are the "long tail" of goods that become commercially viable when the barriers between demand and supply are removed and everything is available to everyone.

[7] For more information about business model innovation, see: Giesen, Edward, Saul J. Berman, Ragna Bell and Amy Blitz. "Paths to success: Three ways to innovate your business model." IBM Institute for Business Value. June 2007.

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